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Economic Conditions
Governmental Finance
United States Securities

New York, August, 1933.

General Business Conditions

THE break in the prices of stocks, grains and cotton during the latter part of July has been a very spectacular affair, and may engage the public attention in a greater degree than its economic importance warrants. Since the forepart of April all the market influences had favored higher prices, including the natural business recovery, the continuous depreciation of the dollar in the foreign exchanges, and the measures adopted under the Industrial Recovery and Farm Relief Acts. Influenced by these factors, and impressed by the declared intention of the Administration to raise the price level, it was natural that far-sighted business men should anticipate their requirements for commodities, and that securities should advance on both investment and speculative buying.

It was also natural that a considerable number of marginal buyers, lacking adequate funds for their operations or relying upon stop loss orders for protection, should push the advance too fast and far. The stop loss order is a device to protect individual traders in accumulated profits, but when such orders are generally prevalent they are a veritable mine under the market.

The danger that speculation would be overdone had been foreseen in all conservative quarters, and President Roosevelt in his radio address last May warned against the ballyhoo route to prosperity. Now that an early reaction has come, however, it would be difficult to show that any but the speculators have suffered greatly from their mistakes, and the latter have taken the most appropriate and efficacious punishment that could possibly be devised. The farmers have had the benefit of higher prices earlier than would have been the case if speculators had not anticipated the improvement, and in considering the part of speculation in the decline its part in the advance must also be taken into account. In the economic situation, while such wide fluctuations are disturbing, they are not the threat that they would have been if the period of speculation had been prolonged, or if business were above normal. Moreover, they have given a lesson of the difficulty of forcing the recovery beyond its natural pace, and the situation hereafter may be more stable accordingly.

The Break in Wheat and Cotton

The position in wheat, which declined 30 cents a bushel during the break, affords an illustration of the situation that had developed in a number of markets. A natural basis for a price advance was laid by the sensational reduction in the crop this season to the lowest figure in 40 years, and by the general business improvement. To these influences were added the effects of the depreciating dollar, which led people to convert their dollars into property, and the measures taken under the Farm Relief Act. These measures affected both wheat and flour prices. The plan to indemnify the farmer for reducing his acreage advanced the wheat market, and flour was advanced additionally by the imposition of a tax of 30c a bushel on the milling of wheat to provide the funds for the acreage reduction payments.

Responding to these varying influences, wheat since the first of April had advanced by 56c a bushel and flour by over $4 a barrel, and prior to the levying of the processing tax a period of great activity set in which compelled many mills to operate night and day. Naturally, however, this great activity did not last, and the breathing period which followed gave occasion for the liquidation of the overextended market.

In cotton similar influences have been at work. There was a shortage of cotton goods in merchants' hands when the seasonal buying movement began after the banking holiday, and the buying was kept going by one influence after another tending to advance prices. The cotton textile industry was the first to put its code into effect under the Industrial Recovery Act, and by reducing operations to 40 hours a week for labor and 80 hours for machinery, and by raising wages, the costs of manufacturing have been substantially in-

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creased. Meanwhile the plan of the Agricultural Adjustment Administration to take 10 million acres of cotton land out of production this season was devised and carried through, and announcement was made that a tax of 4.2c per pound would be levied on the processing of cotton beginning August 1st.

With these stimulating developments coming in succession, the price of cotton rose 5.8c a pound and the price of goods even more, the manufacturer's margin on standard print cloths having advanced from 7.84c per pound on March 31st to 21.19c on July 14, according to the reports of the New York Cotton Exchange; and the demand for cotton goods rose to the greatest volume ever known. Mill operations increased sensationally and consumption of raw cotton during June and up to July 17, when the new working hours went into effect, exceeded that of any similar period on record. After this great activity a quiet period in the markets was evidently in order.

The above instances give natural trade reasons for the reaction, which apply to other industries as well.

Misunderstanding of Inflation

In addition to these trade reasons, there undoubtedly has been a good deal of misunderstanding of the economic situation. It has been assumed that the United States is traveling the road of inflation, and that it is a one-way road; and this assumption alone might well account for the markets over-reaching themselves.

In particular the significance of the decline of the dollar in the foreign exchanges, to nearly 32 per cent discount at one time in July, has been misinterpreted. It has been a center of speculative attention, but except for its stimulus upon speculation, has had less to do with the price advance than many have assumed. It has caused dollar prices of imported commodities such as rubber and silk to be marked up, but could affect prices of exported goods only if it attracted a greater demand for them, and there is little evidence of increased exports due to this influence. In the June foreign trade of this country imports exceeded exports for the first time in two years, which indicates that the chief influence of dollar depreciation upon trade has been to raise the price of imports. Upon commodities not important in foreign trade, such as wheat, which has long been above an export basis, and many others, the dollar depreciation has been only a sentimental influence.

The decision of this country, given in President Roosevelt's statement to the London Conference, not to participate in plans for currency stabilization until the problem of domestic recovery is worked out, implies that the value of the dollar should be governed by the price level rather than the converse. The situation for the time being, however, is that neither is governed by the other, but both by the play of collective judgments and collective emotions in the markets.

It is true that in the long run a depreciation of the dollar must advance domestic prices above world prices through its effects on imports and exports, but there are two important qualifications. One is that it has the effect of depressing world prices, and an advance in domestic prices may thereby be inhibited, as was the case with English prices when the pound sterling depreciated. The other is that such an effect would require a long time to be realized, and could scarcely be an important factor in the immediate situation. Moreover, with this country enjoying a creditor position in the international accounts, except for capital movements, the normal tendency of the dollar is to return toward par, and it can be permanently kept down only by the exercise of measures to maintain prices above world prices, or by formal devaluation.

All this justifies the statement that the decline in the dollar has been an insecure basis on which to rest an early and rapid price advance, and the reaction proves this. It shows the uncertainties that must exist in reliance upon monetary influence to advance prices, and the instability of prices thus advanced. It also is suggestive as to the degree of inflation that might have to be applied to maintain prices at a level far above the world markets.

Trade and Industrial Conditions

There is no ground for ascribing to the market break any important influence on the business situation. The vertical rise of the business indexes continued uniformly during the forepart of July, but in a few lines gave signs of pausing toward the end of the month. This was to be expected after four months of continuous advance, at the greatest rate attained in any business recovery of record, and the general view as to the probability of a Fall upswing is not disturbed by it. On the contrary, the speed of the rise had already roused apprehensions that production was running ahead of the prospective retail distribution.

The table on the next page gives a record of some of the recognized business indexes, showing the percentage of rise from one year ago to the latest figures available. The showing of these indexes is in general the best since early in 1931, and the productive activity of all the industries, as measured by the composite indexes making adjustment for normal seasonal variations, has been in July approximately equal to the peak of the Spring rise in 1931. The index of the Standard Statistics Company, given at 94.3 in the table,

was 93.9 in April 1931 (January 1, 1923=100), and that figure had not since been equalled until the past month. As compared with the 1929 peak, this index shows that half of the decline has been recovered.

	Month of June or Latest Week	Year Ago	Percent Increase
Industrial Activity (Stand. Stat.)	94.3†	55.0	71.4
Checks Cashed, 262 centers, Mill. $	8,082*	6,266	28.9
Freight Car Loadings, Thousands	648*	504	28.6
Electric Power Prod., Mill. Kw. Hrs.	1,648*	1,416	16.4
Steel Operations, Per cent of cap.	58*	16	262.5
Bituminous Coal Prod., Thous. Tons	6,965*	4,155	67.6
Automobile Production, Number	253,000	183,000	38.2
Cotton Consumption, Bales	696,000	322,700	115.7
Silk Deliveries to Mills, Bales	53,627	37,470	43.1
Lumber Orders, Million Feet	187	120	55.8
Rubber Consumption, Long Tons	51,326	41,475	23.7

* Weekly figures. † Month of July, estimated.

With industry going at this rate, and the rising prices influencing manufacturers and distributors to increase their inventories, the question of retail demand assumes great importance. Department store sales during June, as reported by the Federal Reserve Board, showed only the seasonal change from May, and were 4 per cent below a year ago, in dollars. However, these figures indicated a slightly larger movement of merchandise, as prices at the beginning of the month were 8.3 per cent lower, and at the end 3.8 per cent lower, according to the Fairchild index. The dollar sales of chain stores and mail order houses during the month were 7 per cent larger, this figure representing a larger volume of merchandise. Reports from New York City department stores for the first half of July show little change, sales having been 4 per cent smaller than in the same period of 1932. Elsewhere, however, the showing has been better, according to preliminary reports, with chains and mail order stores serving factory centers and agricultural districts generally well ahead of a year ago.

The Question of Purchasing Power

It is usual for retail sales to lag somewhat in a business recovery. Looking to the Fall, consumers' income will be the largest in several years. In June employment in the manufacturing industries increased 7 per cent and payroll disbursements 11 per cent over the preceding month, according to the Department of Labor. This is against the usual seasonal decline, and the record for July will be similar. The advance in security prices from the low represents an enormous increase in buying power.

Moreover, the increase in corporation profits and the better showing in dividend disbursements, as reported in a subsequent article in this Letter, is highly favorable. The turn from a loss to a profit in corporation earnings is a very necessary development in advancing business recovery. Not only does it give the incentive to produce and to increase employment, but it provides the means for repairing the ravages of the depression upon equipment, for making replacements and improvements, and in this manner extending the recovery to the industries making capital goods as well as those turning out articles of personal use. No recovery could progress far unless this important group of industries, including construction and machinery of all kinds, participated in it, and this is a reason why consideration should be given to the profits of industry in the operation of the Recovery Act.

Conversely, the lack of a capital market, out of which industry could finance its capital needs, is one of the unsatisfactory elements in the present situation. It is common testimony that difficulty in fulfilling the requirements of the new Securities Act is one of the obstacles holding up new public borrowing.

There is no ready method other than observation for determining whether general production and consumption are out of line, but the view of General Johnson and other good judges is that the situation is threatening. Hence the efforts during the past month to speed up the operation of the Industrial Recovery Act, the rapidity with which the major industries have prepared their codes, and finally the appeal to all employers of labor to agree voluntarily to fix the maximum work week at 35 hours and minimum pay at 40 cents an hour for factory workers, and 40 hours and $14 to $15 per week (depending upon location) for clerical workers, effective until December 31.

In response to this appeal the President has received an impressive affirmation of support from over the country. There is no question as to the willingness of business men to cooperate in the greatest degree that their circumstances permit. Everyone recognizes that the Administration is making an earnest effort to reestablish order in industry and is entitled to the fullest practicable cooperation. Inevitably differences of opinion arise about features of the recovery program, but on all sides there is a genuine desire to adjust them. The President has given assurance that the program is subject to modification as experience may suggest.

The Record of the Industries

A good test of consumer purchasing power is being provided by the automobile industry, and with gratifying results. Keeping production closely adjusted to sales, the industry turned out 253,322 vehicles during June, the largest total since May, 1931; and many manufacturers, particularly those making low-priced cars, have done as well during July, although sales usually drop in the Summer. The automobile industry is experiencing some

of the deferred replacement buying, and in view of the volume of that pent-up demand, which will be released as purchasing power increases, it would be premature to assign a limit to the upswing. This situation exists in the tire business, and of course in a more marked degree. Tire factories everywhere are operating at capacity, and rubber consumption in June broke all records.

Operations in the steel industry, after having advanced from 14 per cent to 59 per cent of capacity over an unbroken period of 16 weeks, finally ceased to expand during July. Considering the small demand for steel from the construction industry and the railroads, which in the years prior to 1929 consumed about 35 per cent of the output, the halt may appear to some to be overdue. However, the industry's order books are in good condition, and with wages increased July 17 and the Recovery code drawn up there is no room for price weakness. The mills count upon automobile and miscellaneous requirements to maintain their operations until Fall, when they hope for construction and railroad orders to carry on the upswing.

Awards of building contracts continue to run below 1932, but by a smaller percentage than in the earlier months of the year. For the first half of July the totals were 30 per cent under a year ago and 9.4 per cent below June, this drop being less than seasonal. Residential building continues to make the best showing, having turned the corner in May. Public works and utilities construction is lagging, but the Government's expenditures should begin to appear in these figures within the next sixty days. Lumber shipments are the best in two years, and the backlog of unfilled orders the best in four years.

In textiles and apparel the primary markets have been quieter. Textile mills, however, have orders on hand to keep them employed through the Summer and in some cases well into the Fall, and there has been no abatement of operations except that enforced in the cotton mills by the Recovery code. We have noted the record operations of the cotton mills prior to July 17, and the activity in wool, silk and rayon is almost as striking. The silk mills took 53,627 bales of raw silk during June, the highest on record for the month.

Clothing manufacturers are sold well ahead. Shoe factories have been turning out goods at an unprecedented rate, the record output of May and June having raised the first half year's total about 15 per cent over the corresponding period of 1932.

Another group of industries which has made impressive gains is the household equipment group. The long depressed furniture business has boomed, with factories sold up at good price advances.

The Agricultural Situation

Credit for the improvement in agricultural prices over the low may be attributed about equally to natural causes and to the Farm Relief Act. The Government crop report as of July 1 was a sensational document, so far as it related to the grain and feed crops. The figure for Spring wheat was only 160,000,000 bushels, or 100,000,000 below a normal crop. This represents a partial crop failure in both sections of the wheat belt, since the Winter crop is only 335,000,000, and the total of 496,000,000 is the smallest since 1893. The Canadian crop is also reduced, by the same drouth which struck our Northwest, and the July 1 condition was 77 against 99 last year. Moreover the weather has continued unfavorable.

The change in our wheat situation is the sharpest on record. The figure given compares with average domestic needs over the past few years of around 725,000,000, taking no account of exports. These needs may be less this year, and exports negligible. Nevertheless the first substantial reduction in the carryover accumulated during the past six years is indicated. There will be no other grains to replace wheat, the rye crop being given as 25,300,000 bushels compared with 40,400,000 last year, corn 2,384,000,000 against 2,876,000,000, oats 699,000,000 against 1,238,000,000, and barley 170,000,000 against 300,000,000. The hay crop likewise is reduced.

For livestock feeders the situation is not happy, the figures indicating a scarcity of feed from Ohio west to the Pacific Coast. At present prices feeders are unable to recover the cost of grain fed to livestock, and this has caused increased marketings of hogs and cattle, holding their prices relatively below other farm products. This is the way the law of supply and demand operates, and in time it will reduce the supply of livestock and increase its price. However, in view of the measures to assist other farmers under the Relief Act, the feeders are naturally not backward in asking that an allotment plan be devised for them also, and this may be the next development. The dairy industry is affected as the feeders are.

The cotton acreage reduction plan, whereby the Government will pay for the plowing up of the crop, was carried through successfully. Secretary Wallace announced on the 17th that more than 10,000,000 acres had been tendered to the Government for destruction, having an estimated production of 3,500,000 bales. The effect was to move cotton prices up sharply.

Thus between what they will receive for their production, and what they will be paid for not producing, both the cotton and grain farmers are in a happier position than in some time. Wool, hides, butter and other products

likewise have advanced further, though some were affected by the reaction.

Prices to the Consumer

Cheering as this is to the farmers, there is another side to the picture, which is the rise in prices of the things he buys, under the administration of the Recovery Act. It is worth noting for example, that cotton print cloths, 38½" 64 x 60, at 6¾ cents, are approximately the same price as in the early part of 1930. Then, however, cotton was 17 cents a pound in New York as compared with 10.50 now. Similar comparisons could be made for other cotton cloths. These wholesale prices are not immediately reflected at retail, but in the long run must be. Evidently the cotton farmer, whose position was so much complained of in 1930 that the Farm Board was intervening in his behalf, is not gaining much in ability to buy goods made from his cotton. In fact the disparity between cotton and goods is as great as when cotton was selling at its low of 5 cents a pound.

This comparison may make concrete a very important issue, to wit, the effect of the higher prices to the consumer. From the bottom, retail prices of food advanced 6.9 per cent to June 15; prices of department store merchandise 4.2 per cent to July 1; and the cost of living as calculated by the National Industrial Conference Board 1.4 per cent to June 15. Retailers commonly express concern as to the situation when further markups must be added to retail prices, as goods are replaced. The hazard in attempting to meet this problem by raising wages and reducing production, which increases costs and prices, is that the recovery program may become entangled in a vicious circle. To increase the flow of goods in trade channels and employment in the factories the first essential is that the terms of exchange between the various products shall facilitate trade, for it is in the exchange of goods and services that purchasing power lies.

Money and Banking

The supply of funds in the money markets has been ample during July, the reporting member banks in leading cities having had, on the latest reporting date, reserves some $300,000,000 in excess of legal requirements. This surplus, however, has not been uniformly distributed. Whereas in previous periods of excess reserves a great part has been in New York City, during the past few weeks they have been held almost entirely in other centers; and New York City banks at one time purchased Federal funds from Chicago banks to keep their reserves up to requirements.

This situation of course signifies a movement of funds from New York to the interior, and in the early part of the month this movement was quite pronounced. In part it was connected with the usual half-yearly disbursements by corporations, and other seasonal factors; but was also influenced by the suspension of interest payments upon demand deposits by the member banks of the Federal Reserve system, as required by the Banking Act effective June 16, which led country banks to reduce their New York balances.

Due to this shift of funds, a slightly firmer tone appeared in the New York money market, as evidenced by 60 and 90-day collateral loans at an advance of ¼ to 1¼-1½ per cent, and by an increase in the 90-day bill rate on July 7 from ⅜ to ½ asked. Inasmuch, however, as any rise in rates in New York would attract the surplus funds of other centers, it was out of the question for this tendency to go very far.

The chief factors contributing to the excess reserves have been, as heretofore, the return of currency from circulation into the banks, and Reserve Bank purchases of Government securities, which put Reserve funds into the markets. The decrease in money in circulation was slowed down by the temporary expansion incident to the Independence Day holiday, but for the four weeks ended July 26 totaled $74,000,000. The Reserve banks likewise slowed down their purchases of Governments, but took $53,000,000 in the same period. Out of these funds the banks paid off $30,000,000 of rediscounts, reducing them to $161,000,000, which except for a brief period of 1931 is the lowest on record. Of the remaining funds a substantial portion went to increase the reserves of the member banks, which rose to a new high point since the banking holiday.

Demands for credit have shown some increase. The secured loans of the reporting banks in the three weeks ended July 19 rose $116,000,000, and "all other" or the so-called commercial loans (in which, however, sales of Federal funds are included) rose $86,000,000. Concurrently the banks sold Government securities to the extent of $114,000,000, and $7,000,000 of other securities, leaving a net increase in loans and investments of $81,000,000.

These figures show that the increase in commercial demand for funds which may logically be expected to follow the business recovery and price rise has not yet reached important proportions. Whether the money markets will firm importantly, as this demand rises, obviously will depend in great degree upon the rate of return of currency from circulation, and upon the policy of the Federal Reserve Banks with respect to purchases of Government securities in the open market.

Did Gold Cause The Depression?

There have been from the beginning two widely different views as to the cause of the business depression, and therefore as to remedies for it. One of these has been that it resulted mainly and primarily from an inadequacy of the world's monetary system, based on gold, to properly perform its functions as the standard of value and agency for effecting the exchanges of business. It represents that supplies of gold failed to keep pace with the growth of business and rise of prices and that the break in prices resulted from an insufficient base under the expanding volume of credit. This theory, however, itself is lacking in factual support. Authoritative figures (*) show that the gold reserves of the world increased by over 100 per cent from 1913 to 1929, which unquestionably exceeded the increase of production and trade, reckoned even at the higher level of prices. In 1929 the Financial Committee of the League of Nations created a body of inquiry, called the "Gold Delegation," eleven members from ten countries, to examine into this subject and make a report thereon. The report was made in 1931, and the substance of it is contained in the following extract:

> **We wish at this point to record our opinion that the world's total stock of monetary gold, apart from any consideration as to its distribution among different countries, has at all times in recent years been adequate to support the credit structure legitimately required by world trade and that the rapid decline in prices which began in 1929 cannot be attributed to any deficiency in the gold supply, considered in this sense.**

It is true that individual members of this body were of the opinion that as a result of the war and the extraordinary shifts of trade and capital caused by the war and war debt payments, an undue concentration of gold had occurred in a few countries, the United States in particular, and that this had disturbed the normal balance of the world economy. This, however, obviously was a situation chargeable to the war, and must be counted with the other derangements and costs of the war. The Delegation held that it had no significance as to the aggregate supply of gold available for business purposes, and since this country was the principal holder it evidently did not cause the break of prices in this country.

The Disorder in Industry and Trade

The other explanation of the depression is that it has been due to a widespread disorganization of price and trade relations, resulting from the war. This view has been consistently advanced in these columns, and is set forth at length elsewhere in this issue (pp. 124). It holds that the monetary theory of the depression exaggerates the part of mere currency in modern business, since commodities and services really pay for each other in the exchanges, with currency only the media of exchange. This view is verified by the very argument made in behalf of debtors, i.e., that they must pay their debts with what they have for sale, and that great injustice is done them by the fall of prices. It is verified also by the fact that 90 per cent or more of all the payments of this country are made by means of private checks, which cancel out in the clearing houses.

It is only when trade is thrown out of balance by disorderly production or a disruption of price relations (usually both) that bank clearings fail to practically settle themselves. Unbalanced clearings reflect unbalanced trade, which means a contraction of purchasing power and resulting unemployment.

Proven by the Agricultural Situation

This is proven by the disorder existing since 1920 in the relations between primary products and manufactured goods and transportation costs. The war created new conditions in the production of all the staple products from which more than one-half of the inhabitants of the world derive their livelihood. An eminent European economist, Professor Cassel, of the University of Stockholm, in an article discussing this disruption of relations, has said that *"the entire world economy has thus been put out of balance."*

The primary cause of this price situation was the stimulation of production outside of Europe by the war. Efforts to reach an agreement for a restriction of wheat production have been one of the leading activities of the recent London Conference. And finally conclusive proof of what the war did to agriculture is had in the unprecedented policy of the United States Government in hiring farmers, at the cost of hundreds of millions of dollars, to reduce their acreage in the principal crops. This extraordinary action is based upon the premise that this country has overdone its agricultural development, that surplus production is the cause of the low prices and that this loss of farm purchasing power is a leading factor in the depression and unemployment. Evidently agriculture is badly out of balance with the other industries, and if this has been an important influence in the distress of agriculture and in the origin of the depression, what becomes of the case against the monetary system?

Another important subject of international negotiations has been sugar, the production of which was overstimulated, first, by war conditions and then by the fostering legislation of numerous countries, until producers every-

(*) Federal Reserve Bulletin, June, 1933.

where have been ruined and their purchasing power destroyed. Coffee, tea, rubber, the vegetable oils (which compete with butter) all were overstimulated in like manner with like results, and the same was true of silver, copper, lead, zinc, tin and coal.

In the important Appalachian Coal case recently decided in the Supreme Court of the United States, Chief Justice Hughes, who rendered the opinion, said:

The findings of the District Court, upon abundant evidence, leave no room for doubt as to the economic condition of the coal industry. That condition, as the District Court states, "for many years has been indeed deplorable." Due largely to the expansion under the stimulus of the Great War, "the bituminous mines of the country have a developed capacity exceeding 700,000,000 tons" to meet a demand "of less than 500,000,000 tons."

The building industry, and construction work generally where not directly related to the war, were restricted during the war and then overstimulated to make up for the resulting deficit, with results that are familiar. Other examples might be named of the manner in which industry was thrown out of its normal stride by the war, with resulting disturbance to wages, prices, and all the relations of the business world. The passage of the Industrial Recovery Act is tangible recognition of widespread disorder in industrial relations. The monetary theory of low prices takes no account of these disorders in industry and trade.

The Collapse of a Theory

It is not too much to say that the monetary theory of the depression has been completely disproved by the events of the last five months. Giving attention particularly to conditions in this country, we give the figures for money in circulation (outside of the Treasury and Reserve banks) in the five years ended with 1929 and the years since as follows:

Total Currency in Circulation
(In Millions of Dollars)

June 30, 1925	4,734	Jan. 31, 1933	5,644
June 30, 1926	4,835	Feb. 28, "	6,545
June 30, 1927	4,745	Mar. 8, "	7,538 (Peak)
June 30, 1928	4,797	" 31, "	6,319
June 30, 1929	4,746	Apr. 30, "	6,008
June 30, 1930	4,522	May 31, "	5,812
June 30, 1931	4,822	June 30, "	5,720
Dec. 31, 1931	5,646	July 26, "	5,601
June 30, 1932	5,695		
Dec. 31, 1932	5,674		

It will be seen that the amount of currency in use in 1929 and previous years was less than at any of the dates since, and it is certain that the amount in the former years was ample to serve the country's trade. The larger amounts outstanding since the middle of 1931 have been due to hoarding. The volume now is about the same as one year ago, although the volume of trade is notably larger. The several acts of legislation and the policies of the Reserve banks designed to increase money in circulation have had no such effect, which shows that the quantity that will stay in circulation depends upon the state of trade and not upon the amount that may be printed.

The stock of gold held by the Reserve banks and the United States Government, which measures the capacity for bank credit expansion, is shown at intervals in 1929 and down to the latest date:

(In Millions of Dollars)

June 30, 1929	3,955	June 30, 1931	4,592
Dec. 31, "	3,900	Dec. 31, "	4,051
June 30, 1930	4,178	June 30, 1932	3,466
Dec. 31, "	4,225	Dec. 31, "	4,045
		June 30, 1933	3,996

It will be seen that at only one of the dates named since 1929 have the gold reserves been less than in 1929, and that on June 30, 1933, they were slightly higher than on June 30, 1929. The exception was June 30, 1932, which was at the end of the great movement of gold out of the country in the first half of that year, completely reversed in the last half. These figures prove that the gold reserves since 1929 have been ample to sustain a volume of credit and a level of prices as high as existed in 1929.

Moreover, it is well known that in 1929 a large part of the bank credit in use was employed in speculative operations of various kinds, in stocks, real estate, and other investments not directly related to industry or trade, and that since then these credits have been largely liquidated. These resources, therefore, are now available for business purposes. That they have been used to a diminishing extent since 1929 has been due to the fact that, owing to disorder in trade and prices and to various conditions affecting credit, the public has been disinclined to use them. *The will to use them did not exist.* The *will* to use money or credit is an important factor which the advocates of more money often leave entirely out of their calculations. In other words, they neglect the factor of confidence, which may be affected by monetary legislation.

The Revival of Business and Rise of Prices

Since the bank holiday in March and the general restoration of confidence in banks, for which the Government at Washington is entitled to much credit, a marked revival of business has occurred, due to a number of influences, which have been recounted under "General Business Conditions". The suspension of gold payments prompted a transfer of ready capital out of the country, at first by shipments of gold, and when these were embargoed, by exchange operations which involved the depreciation of the dollar in the foreign exchanges. This was followed by legislation empowering the President to issue large sums of paper currency and to reduce

the gold content of the unit dollar to the extent of 50 per cent, altogether creating a presumption that unless prices advanced without such action they would be forced up in this manner. Thus all conditions, and the opinions of inflationists and anti-inflationists alike, pointed to higher prices, which naturally caused business men to conclude that it was better policy to have commodities or stocks than money, and started a buying movement.

There is no need now to carry explanations farther; interest centers in the effects, and our immediate purpose is to show that a pronounced change in the business situation has come about without any inflation of the currency. A very substantial rise of prices has occurred, as appears from the well known index tables quoted below.

Rise of Commodity Prices from 1933 Low

General Indexes	1933 Low	1933 High	Per Cent Change
Moody's (15) (Dec. 31, 1931=100)	78.7	148.9	+89.2
Journal of Commerce (30) (1927-1929=100)	36.0	61.7	+71.4
Dun & Bradstreet (30) (1930-1932=100)	67.9	113.5	+67.1
Annalist Wholesale (74) (1913=100)	79.8	107.0	+34.1
Bureau of Labor (784) (1926=100)	59.6	69.7	+16.9
Bureau of Labor—Farm Prod. (1926=100)	40.2	62.7	+56.0

Note: All indexes are weighted. Figures in parentheses indicate the number of commodities included. Moody's commodities with weight attached to each are as follows: wheat 13, cotton 13, hogs 13, steel scrap 10, sugar 10, wool 7, copper 5, hides 5, corn 4, rubber 4, silk 4, coffee 4, lead 3, silver 3, cocoa 2. These are all staples of the kind that has suffered the largest declines and which always respond most rapidly to a business revival. The longer lists include commodities of less importance or of a less primary character, i.e., semi-manufactured or finished manufactures, in which labor is a larger factor, and in which the price changes always are smaller. Thus the Bureau of Labor index, based upon 784 commodities shows the smallest advance, but an advance of 56.0 in the Farm Products group.

The Will to Buy

This advance of prices has been wholly due to a changed attitude on the part of the business public. Changing conditions have suddenly developed *the will to buy,* which had been weakening since 1929 until it had reached an abnormally low state, with goods holdings of all kinds very low.

This right-about face was not unprecedented. Something very like it occurred in 1879-80, after six long years of depression following the crisis of 1873, and again in 1898-99 after the crisis of 1893. In both of these periods of depression agitation had been rampant to change the monetary system. It was said then, precisely as has been said in recent months, that prices never would rise, debts never would be paid, labor never would find employment and prosperity never would be known again, unless the monetary standard was changed. And then in both instances prosperity suddenly returned and the agitation ceased entirely. Conditions had righted themselves.

Whether this situation was ready to right itself completely last Spring, or is yet, is something about which opinions may differ. The disorders resulting from the war and the boom period were very great and it may be doubted that all of the necessary readjustments have been made. The farm program and the industrial program have been undertaken upon the theory that serious maladjustments remain to be corrected by some other means than an increase in the supply of money or change in the standard.

Plenty of Money and Credit

The increase of activity and of prices which has occurred has made no marked demand upon the available supplies of money and credit. There is no apparent reason related to these supplies why the recovery may not go on until every worker has a job and the price level is as high as in 1926-1929. It depends upon the trading relations between the industries and the full restoration of confidence.

Senator Thomas, author of the amendment to the Farm Adjustment Act authorizing the President to issue $6,000,000,000 of additional currency and devalue the gold dollar one-half, is quoted as follows:

> If the kind of inflation we are having brings back the 1926 price level, then perhaps we may not need to resort to physical inflation of the currency.
>
> If we can have living values again—wheat at $1.50 a bushel, corn at $1 a bushel, cotton at 15 cents a pound and other commodities selling for comparable prices—credit inflation or expansion will come naturally and automatically. It may come about that the very fact that the President has the power to inflate will make the exercise of such power unnecessary.

In view of the rise of cash wheat in a few months from the low of 44 cents to $1.15, of corn from the low of 23 cents to 64 cents, and of cotton from the low of 5.90 cents to 11.75 cents, (cash prices) without any sign of a scarcity of money, the goals set by Senator Thomas do not at all appear unattainable. Reports from the farming districts say that the psychology there has undergone a complete change.

That the legislation has had an effect in inducing a conversion of cash or bank deposits into goods and stocks is doubtless true, but as stated above the rise of prices has not been wholly due to this cause, and subsequent happenings in the markets have shown that it would have been just as well if the rise had not been quite so fast and furious, or perhaps if the "flight from the dollar" had not been a factor in it. The markets plainly were over-

done, but the effect upon prices of a buying demand has been once again fully demonstrated. As in all other periods of low prices the situation has not been due to lack of money but lack of the buying demand.

Furthermore, regarding the influence of "the power to inflate," even if it be true that the prospect of inflation has had an influence in stimulating the conversion of cash into stocks and merchandise, it hardly can be argued that fear about the money is a better basis than confidence for enterprise and enduring prosperity. Credit is an essential factor in modern business, and contracts of every kind are based upon money. Every time of expanding business has been a time of expanding credit, and misgivings about the money tend to deter those who have it from either granting new loans or renewing old ones.

Give the Natural Forces Time

There is no reason to think that the recovery movement is exhausted. The new buying power which has been created by the rise of primary products and by the return of a million or more workers to employment will increase consumption and thus give further impetus to the movement. In place of the vicious cycle of declining trade, falling prices, diminishing employment and diminishing consumption, a reverse cycle has begun, and if wise counsels prevail, all of the lost ground may be recovered. The extensive plans adopted for the restoration of a "balanced economy" are not yet effective. In short, the latent forces making for natural recovery are just getting under way. What is needed now above everything else is confidence in the natural forces which have made so splendid a beginning and intelligent cooperation with them.

At some stage in our policy it surely will be necessary to reestablish confidence in the stability of money and credit, and it would seem that the sooner this is done the better. In view of the record of these five months, who can now believe that the provisions for increasing the monetary circulation by $6,000,000,000 and for devaluing the dollar by one-half are necessary to restore prices?

Considering that a revival of prosperity is a spreading movement, gaining strength as employment and buying power increase and as the different sections of the industrial system receive stimulus from each other, it is evident that time is required to bring all the idle resources into action and accomplish the full recovery. If now, while this orderly development is going on, action should be taken to hasten the rise of prices by forcing currency depreciation, alternative dangers would threaten, to-wit, that the action would impair confidence in real recovery, or that if the level of prices planned for should be attained in this manner and without impairing confidence, the latent forces of natural recovery still operating would carry the price-movement far beyond the level contemplated, thus upsetting the very equilibrium that had been sought and launching the country upon another era of inflation and speculation; in short, that the inflationary forces having been released, could not be recalled or controlled as the advocates of a "managed" currency vaguely theorize.

As to a Managed Currency

Practically all of the change in the last five months has been wrought by a change of attitude on the part of the public, i. e., from unwillingness to buy to willingness to buy—a change of mentality induced indeed by a combination of circumstances, but not by any change in monetary or banking conditions. The same has been true of the recovery from every other depression experienced in this country. Moreover, if attention is given to all of the conditions which brought about the depression and fall of prices—the war, the phenomenal demand for man-power and natural products, the inflation of credit, the increase of debt, the disorders in production and trade, the loss of confidence, the spread of panic—it will be found that violent changes, both in conditions and psychology, were responsible for the price fluctuations, rather than any defect or deficiency in the gold standard or this country's monetary system.

The managed currency idea is that a monetary system should provide a stable level of prices from year to year and from generation to generation, regardless of all the influences inherent in human nature and arising from the activities of men which naturally affect prices. We will not discuss the theory now on its merits, for lack of space, but the mere statement of what is expected of it is enough to show that it is an ideality rather than a remedy for price-disorders that can be promptly put into effect or that will inspire confidence.

Of course, there is a degree of management in all modern currencies. The best system of management ever known was that which linked nearly all the currencies of the world together through the gold standard, with each country free to manage its internal currency and bank credits to suit itself. It is generally agreed that it is fundamental to order in international trade and finance that the currencies shall be linked to each other. It is conceivably possible that if all the nations will return to the gold standard a larger degree of cooperation between central banking institutions may be gradually developed, but there is no pros-

pect whatever that the nations will agree to international management of national currencies. It seems highly improbable that the United States Government ever will give serious consideration to such a proposal. This being so, it is possible for the United States to have a managed currency only by abandoning the idea of having firm exchange relations with other countries, which from every viewpoint would be deplorable.

Gain in Second Quarter Profits

The broad expansion in business activity that began last March is reflected in the corporate reports published during the past month, covering the second quarter of the year. A tabulation of the statements of 163 representative industrial companies engaged in diverse lines of manufacturing and trade shows a marked upturn in earnings in contrast with the downward trend that had been almost continuous for more than three years. Approximately 80 per cent of the companies improved their earnings as compared with the preceding quarter, and 70 per cent were better than in the second quarter of last year. Only 35 per cent of the companies operated at a deficit during the second quarter of this year, as against 58 per cent in the preceding quarter and 51 per cent in the second quarter of 1932 and, in the majority of cases the companies still in the red have been able to reduce their deficits materially.

Combined net profits, less deficits, of the 163 industrial companies amounted to approximately $77,000,000 in the second quarter of this year, while in the first quarter the same companies had a deficit of $21,000,000, and in the second quarter of 1932 profits of $5,000,000. At the beginning of this year this group had a net worth of $8,553,000,000. The improvement was unusually large in such industries as automobiles and accessories, baking and food products, chemicals and drugs, electrical and other machinery, building materials, merchandising, mining and miscellaneous manufacturing.

The increase in number of companies now on an earning basis and in their aggregate profits is shown by the following summary:

In Thousands of Dollars

	Second Quarter 1932	First Quarter 1933	Second Quarter 1933
Reporting Profits			
Number	80	69	106
Profits	$63,352	$46,006	$108,774
Reporting Deficits			
Number	83	94	57
Deficits	$58,397	$66,929	$ 31,814
Total Reporting			
Number	163	163	163
Net Profits	$ 4,955	D-20,923	$ 76,960

The recovery in corporate earnings has permitted more favorable dividend declaration by many companies, and while the dividend trend during the second quarter was still downward the rate was slower than before. According to the compilation by the New York Times, which embraces not only industrial but also railroad, public utility and financial companies, dividends were resumed or increased by 63 corporations in the second quarter, compared with 45 in the preceding quarter and 28 in the second quarter of 1932. Dividend reductions and omissions totaled 570 as compared with 609 and 1,000, respectively. Total dividends declared amounted to $619,000,000 in the second quarter, as compared with $603,000,000 in the preceding quarter and $727,000,000 in the second quarter of 1932. Since July 1 the number of dividend reductions and omissions has been practically matched by the number of resumptions and increases and the usual cycle of dividend payments, of marching up hill and then down again, has apparently been completed.

Earnings for the Half Year

Earnings for the first half year are at a somewhat higher level than a year ago, the extremely poor results in the initial quarter of 1933 being offset by the sharp gain in the second quarter. The accompanying table gives comparative figures covering the first half year for a group of 240 companies, including many companies which publish semi-annual but not quarterly statements, with a net worth aggregating $10,002,000,000. Combined net profits for the half year were $21,000,000 in 1932 and $66,000,000 in 1933, while the annual rate of profits return on net worth rose from 0.4 per cent to 1.3 per cent. The rise in rate of return is due in part to the reduction in net worth last year, brought about by operating deficits, by payment of dividends in excess of earnings and by writing down of capital and surplus in connection with revaluation of plants and properties, inventories, receivables, investments, goodwill and other assets.

Railroad Earnings

Recovery in general business has resulted in a heavy increase in railroad freight traffic and gross revenues, and has lifted sharply the net operating income remaining after ordinary expenses but before interest charges. In view of the desperate financial condition in which many railroads found themselves last year and the large loans from the Reconstruction Finance Corporation that were necessary because of their lack of earnings and inability to refund maturing bonds and notes, the recent betterment in railroad finances is one of the most encouraging developments since the depression began. Reflecting the improvement in railroad credit, the railroad bond market has enjoyed a sensational rise this year, the Dow-Jones index of ten first grade rail bonds

INDUSTRIAL CORPORATION PROFITS FOR FIRST HALF YEAR

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends.

Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industry	Net Profits Half Year 1932	Net Profits Half Year 1933	Per Cent Change	Net Worth January 1 1932	Net Worth January 1 1933	Per Cent Change	Annual Rate of Return Per Cent 1932	Annual Rate of Return Per Cent 1933
1	Auto—General Motors	$15,019	$48,068	+220.1	$923,803	$860,869	— 6.8	3.2	11.2
8	Auto—Others	D-6,042	D-5,218	....	211,583	177,152	—16.3	......	......
18	Auto Accessories	D-5,210	D-1,493	....	201,014	165,669	—17.6	......	......
6	Baking	13,861	10,161	— 26.7	284,290	263,485	— 7.3	9.7	7.7
9	Building Materials	D-5,727	D-3,273	....	181,574	169,045	— 6.9	......	......
11	Chemicals	24,667	25,746	+ 4.4	954,242	894,862	— 6.2	5.2	5.7
8	Coal Mining	D-945	D-1,110	....	109,949	101,282	— 7.9	......	......
5	Construction	977	D-667	....	84,809	70,141	—17.3	2.3	......
9	Electrical Equipment	1,222	D-3,389	....	713,037	631,778	—11.4	0.3	......
15	Food Products—Misc.	37,867	36,257	— 4.3	702,626	631,747	—10.1	10.8	11.5
10	Household Goods	D-2,508	6,466	+	249,208	207,589	—16.7	......	6.2
1	Iron & Steel—U. S. Steel	D-36,671	D-25,358	....	2,003,693	1,911,145	— 4.6	......	......
16	Iron & Steel—Others	D-33,469	D-26,988	....	1,423,383	1,332,185	— 6.4	......	......
11	Machinery	D-2,391	D-1,517	....	178,105	128,542	—27.8	......	......
10	Merchandising	D-4,302	2,175	+	241,601	211,589	—12.4	......	2.1
6	Mining, Non-ferrous	1,306	2,537	+ 94.2	108,523	103,704	— 4.4	2.4	4.9
5	Paper Products	672	127	— 81.1	105,549	101,249	— 4.1	1.3	0.2
11	Petroleum	7,894	D-9,453	....	870,156	752,838	—13.5	1.8	......
4	Printing & Publishing	5,614	1,665	— 70.3	71,961	64,867	— 9.9	15.6	5.1
4	Railway Equipment	D-888	D-1,353	....	179,126	169,166	— 5.6	......	......
4	Restaurant Chains	801	D-187	....	55,862	39,868	—28.6	2.9	......
4	Shoes	3,722	4,605	+ 23.7	162,022	148,784	— 8.2	4.6	6.2
8	Textiles	D-1,444	596	+	54,119	46,145	—14.7	......	2.6
5	Tobacco (Cigars)	891	1,131	+ 26.9	66,636	57,098	—14.3	2.7	4.0
33	Miscel. Manufacturing	8,803	7,527	— 14.5	494,877	440,167	—11.1	3.5	3.4
18	Miscel. Services	D-2,525	D-753	....	376,373	320,904	—14.7	......	......
240	Total	$21,194	$66,302	+218.4	$11,008,121	$10,001,870	— 9.1	0.4	1.3

D—Deficit.

moving up from a low of 80.35 to a high of 93.51 and the index of second grade rails from a low of 55.97 to a high of 77.60. Comparative figures for the first six months of 1932 and 1933 are given below, with the latest month partly estimated:

In Millions of Dollars

Month	Gross Revenues 1932	Gross Revenues 1933	Net Operating Income 1932	Net Operating Income 1933	Net Income After Charges 1932	Net Income After Charges 1933
Jan.	$ 272	$ 272	$ 11	$ 13	$D- 29	$D- 30
Feb.	264	212	22	10	D- 19	D- 33
March	286	218	33	11	D- 6	D- 32
April	265	225	20	19	D- 20	D- 25
May	252	255	12	41	D- 30	D- 2*
June	246	279*	13	45*	D- 21	2*
6 Mos.	$1,601	$1,417	$112	$139	$D-127	$D-120

* Partly estimated. D—Deficit.

Results given above for the first half of the year 1933 indicate that improvement in railroad earnings still has a considerable distance to go before there will be any liberal margin over bond interest charges to apply on the common and preferred stocks and justify still higher share prices, but the upturn in trend is extremely important. Earnings of the railroads, as well as the industrial companies, during the latter half of the year should make an increasingly favorable comparison with the corresponding period last year, when the trend was sharply downward.

The Possibilities of Industrial Control

Theoretically the gains from centralized control of the economic system may be thought of as possibly very great, but almost everyone will qualify his expectations by saying that "everything depends on the management." It is possible that centralized control of all industry might be so good for a time that the aggregate of results would be above the record of free industry, or so bad as to be far below that record. Under free industry some of the management is good and some of it bad, with the general result that the good succeeds, the bad does not, the waste is charged up to experience, and the record of the last 100 years shows marvelous progress to have been made. Whether progress would have been as great under centralized control as under free industry is a subject upon which any one can have his own opinion.

It has been often said superficially that a wise and benevolent dictatorship would furnish the best government that could be had, but notwithstanding the occasional revulsions of democracies from their own rule, the dictator idea does not make real headway. Resort to it only means that over and above everything else all peoples are agreed that law and order, with leadership and authority, is the first requisite of social life, and that at times of

despair over the weaknesses of democracies, or in emergencies created by or resulting from War, they will welcome relief by forms of government which promise to be immediately more effective. There is no reason to think that the people are less tenacious of freedom in the ordering of their daily lives than they ever have been.

It is not to be assumed that the experiment in industrial control now being undertaken will be revolutionary in administration or results, or anything more than what it purports to be, viz: a temporary means of aiding private industry to regain its equilibrium, partly through greater freedom in cooperation than the law has hitherto permitted, and partly by the support of law and authority. It is probable that the hurriedly formed codes and regulations will represent a compromise of opinions, but conservatively administered this grant of authority should be helpful and the experience teach lessons of lasting value.

Control of the workings of the economic system in its details would call for some such intimate knowledge of it as the skilled surgeon or physician has of the vital processes of the human body. Both are highly intricate and nicely adjusted systems which sometimes get out of order, and while there is a border of debatable ground surrounding every body of learning there is a science of physiology and a science of economics, each entitled to be so called because it represents the agreed conclusions of persons generally recognized as authorities on the subject.

There are questions in economics over which disagreements occur, but the authoritative conclusions are based upon careful studies of the development of industry and trade, from the simple conditions when everybody did everything for himself to the vast system of production and trade existing today, in which everybody does little directly for himself because every want is ministered to by specialists possessed of a wealth of skill, knowledge and facilities which individuals of themselves never possibly could command. The whole development and rationale of the system should be known in order to have a clear understanding of the disorders to which it is subject.

The Importance of Relations

The lesson which stands out in any analysis of the economic system is the importance of the relations between all parts of the system and of the common interest of all parts in the efficiency of the system as a whole. This is illustrated by an industry which has numerous subdivisions contributing to the product. The working force of a shoe factory consists of many groups which perform independent operations upon each shoe, besides the "overhead" organization, and perhaps collateral organizations supplying materials, etc. It is necessary that all of these groups shall be, numerically or in working capacity, in balanced relations to each other, in order to prevent loss of time — *unemployment* — and that the best results may be had. Evidently this is essential to the success of the business and stability of employment in it. If the groups get out of step, they hold each other back, and diminish their own earnings and those of the business.

Furthermore, every group of industries and every branch of service in the entire industrial system bears a relation to that system as a whole corresponding to the relation which each group of workers in the shoe factory bears to that business as a whole. The whole system and all of its subdivisions are tied together in the task of supplying the wants of the public, and waste or disorder anywhere impairs the results to all.

The equilibrium of relations between the subdivisions of a factory organization is maintained by the management, but there is no overhead authority to maintain the equilibrium between all the parts of the economic system. This has been maintained in the past by the law of supply and demand and the discipline of the competitive system, and so effectually that the participants have scarcely known that there was any cooperation or compulsion about it.

Wages, Prices and Distribution of Product

The rates of compensation for the different kinds of work and the prices of different products and services are the most important subjects of controversy in the economic system, but they are fundamentally regulated by the law of supply and demand. The available working force is automatically distributed in the various industries and occupations by the varying rates of pay. No other system of distributing the labor supply is conceivably practicable. The Soviet Government, which began with the system of equal pay for everyone, found it necessary to adopt the system of pay according to work, in order to secure the cooperation of the workers in their distribution as needed and to provide employment for all, and the capitalist system, instead of being controlled or dominated by a few, as absurdly alleged, is shaped and directed by the wants and purchasing power of the general public and by the initiative of every person who can create a new want or a new way of ministering to an old want. The system is changing continually to meet the popular will, making new fortunes and wiping out old investments, with no consideration for anything but the commands which come through the markets. And while the public in its consum-

ing capacity dominates the markets, the same public in its capacity as producers classifies and distributes itself in the industries by the diversity of qualifications and according to the varying values which the public itself places upon different goods and services. The rewards of management and of capital are won as they may render aid in the processes of production and exchange.

The economic product is distributed back to the producers on the basis of the contribution of human effort by each participant, as valued in the markets. Contrary to common opinion the share of capital is very small, probably not more than 5 per cent of the aggregate product, which is insignificant in comparison with the increase resulting from the use of the capital equipment. A moment's reflection should satisfy anyone that the share of the total production consumed by or devoted to the rich is small, but we shall recur to this phase of the subject at another time.

The Necessity for Balanced Relations

The climax of perfect organization would be achieved, as we quoted from Dr. Richard T. Ely last month, in "that balanced production which giving employment to all labor, all capital and other economic resources would produce a maximum of satisfaction of human wants." Of course, a perfect state of balance never is attained, for changes are always going on in the industries and any change would affect every part of a perfectly balanced system. Nevertheless it is a guiding principle that the more nearly the system can be kept to the balanced state the higher its productivity will be and the higher the general state of welfare will be. In this state the community would be getting all that the system could give at the existing stage of development. No change in balanced relations could be made without lessening the results; the compensation of no single group could be raised without thereby depressing the compensation of the other groups, or without causing unemployment in the group gaining the supposed advantage. *Whenever the economic system is thrown out of balance, unemployment results, and conversely, whenever unemployment appears it is proof of an unbalanced condition.*

"Order is Heaven's first law," and the principle of the equilibrium is seen everywhere. All of the worlds that swing in space are held in their places by counterbalancing influences. Chemistry teaches that the mysterious forces with which it deals are in a state of rest only when in balance with each other. The animal body is an intricate and delicate organism, composed of many elements which are undergoing change daily, and every dietitian or skillful livestock feeder knows that unless the food ration is in balanced proportions the unmatched portion will be unassimilated, ***which means unemployed.*** Every great musical composition consists of a harmony of vibrations, every note out of place produces a discord; and so in the economic system every man without a job is a misplaced and discordant note.

Dangers of Economic Control

The sound idea in the Industrial Recovery Act is that of restoring the equilibrium throughout industry. The ideal way to do this is by developing the conscious purpose of coöperation in the economic system, thus emphasizing the common interest in the efficiency of the system as a whole. Another is by curbing the abuses of competition, such as unfair methods, sweat-shop wages, etc., without impairing the freedom or rewards of progressive business management.

It will not be questioned that there is danger in any attempt to regulate business by control in the hands of the political government, quite aside from any possible relation to partisan politics. There is danger that unsound ideas urged in all sincerity in the name of social welfare may influence its policies. Among such is the theory just now widely prevalent that capacity for production has so increased that the industrial problem is no longer how to enlarge the supply of comforts which all the people would like to enjoy, but how to fairly divide a limited amount of employment. This theory is a mistaken one and will hamper social progress.

In our last issue, in comments upon this idea, the suggestion was made to readers entertaining it that they mentally divide the families of this country into two groups, one comprised of the 10 per cent having the highest money incomes and the other group including all remaining, and ask themselves whether the members of the latter group would not be glad to raise their scale of living to the present level of the 10 per cent group. In response we have received letters treating this suggestion as palpably absurd, on the ground that by no possibility could the purchasing power of the 90 per cent be raised to accomplish this end, no matter what the productive capacity might be. These letters show the prevalence of two persistent fallacies, viz: (1) that there is only a limited amount of work to be done in the world, and (2) that purchasing power originates in money. The writers miss the point that purchasing power and the standard of living originate in labor and the products of industry, rather than in money-wages or money. The only obstacle to raising the average living standard of the 90 per cent to the present average level of the 10 per cent is that at present it is impossible to produce the increased quantities of all the goods that would be required. Nominal wage-increases in

money would not produce them, but there is reason to believe that the industries will do it, sooner or later, if permitted, and it is certain that if the goods are produced by the different industries in proper proportions and priced in proper relations, they will buy and pay for each other in the markets and inevitably enter into the standard of living.

It is pertinent to the opposition which exists to increasing the efficiency of industry that with all of the improvements in production made since 1913, the cost of living in the United States in June, 1933, as calculated by the Bureau of Labor, was 28.3 per cent above the level of 20 years earlier, and this in money alleged to be high-priced because commodities are low-priced.

The fact that the industrial system functions by an exchange of services, of itself disposes of the theory that there may not be work enough for everybody. The people of this country would scrap all their possessions every year or oftener, for the sake of having the latest products, if they could pay for them with their own services, and had nothing else to do. It would be as practical to talk about exhausting the possibilities of exchanging conversation as to talk about exhausting the possibilities of exchanging services.

The Length of the Work-Week

There is room for differences of opinion as to how many working hours there should be in a week, and that may well be left to the workers themselves, to be considered in connection with what they want their standard of living to be, but they should have a clear understanding of whether they would rather have more leisure or more things. There is no reason to think that at any given time the industrial organization can produce as much in 30 hours as it can in 40, or as much in 40 hours as in 48, and certainly it cannot distribute more than is produced. A shortening of the hours in which the industries operate is a curtailment of production to offset the gains of industrial progress, based on the theory that such gains force unemployment.

Furthermore, if the arrangements being made for 30 hours of work in one line of industry, 36 in another, 40 in another and so on, include minimum weekly wages which have the effect of increasing the costs and selling prices of goods, there is danger that the system will be unbalanced and that the desired increase of consumption will not occur. The work-week cannot be shortened and hourly wages raised on that account and the costs passed on to consumers, without affecting the quantity of goods sold and the amount of employment that can be given. A victorious fight to raise a minimum wage-rate does not assure employment at that rate, for if the rate does not correspond to conditions it will cause unemployment. Consumers finally determine all such questions. They have only a limited amount to spend and make their own choice of the best use for it.

Wages, employment and costs of living are all factors in the inevitable equilibrium. The problem of unemployment is not satisfactorily solved by taking work away from those who have it and giving it to others, but by regaining the normal relations which will afford employment for all, enable all the products to enter into consumption, and thereby provide a standard of living higher than would be possible under any scheme of restricted operations.

Building Up Purchasing Power

The air is full of well-meant talk about building up purchasing power, much of which does not recognize the fact that purchasing power given to one group at the expense of other groups does not increase the aggregate. It is the bootstrap method of increasing purchasing power. It is a familiar fact that the industries have been working for three years on very small margins of profit or without profits, and it is unlikely that they are in position to absorb rising costs without increasing their prices. While it is probable that there is little basis for the charge of profiteering, it is certainly an illusion to think that costs can be raised without affecting prices at least in corresponding degree.

It is only as the abnormal disparities in wages and prices are corrected, that purchasing power can be increased. Here the opportunity exists because both sides gain by an increase of consumption. Since all groups in the system buy from and sell to each other *and nowhere else*—virtually an exchange of products—a group which holds its prices above the normal exchange level lessens the ability of the other groups to take its goods, with the result that trade languishes, consumption declines, *unemployment occurs,* and all groups suffer from the common cause—unbalanced trade relations.

Unbalanced Relations Between Wage-workers

The question of fair exchange relations arises not only between the farmers and wage-workers but among the latter, for wage rates have had a great lack of uniformity since 1929. There were more than 48,000,000 gainfully employed persons in the United States in 1930 as reported by the census, and of these only 10,622,000 were employed in the manufacturing industries and on the steam railroads, where attention is just now largely centered. It is well known that since 1929 wages have fallen much more in the relatively small industries and in employments outside of industry than in the large groups. We referred last

month to the recent bulletin on wages issued by the National Bureau of Economic Research and prepared by Professor Leo Wolman, who is a member of the Advisory Committee for Labor of the Economic Recovery administration, and to its showing of the changes in the "real weekly earnings" of employes in some of the principal industries from 1929 to 1932. The figures given are based upon the payrolls, and make a comparison of actual earnings in 1932, whether for full time or short time, with such earnings in 1929, by means of plus or minus percentages, all earnings being reduced to purchasing power by comparison with cost of living figures. We quote:

Applying this figure to the percentage changes in earnings in the same period, real earnings, or the purchasing power of money earnings, in 1932 are shown in the following tabulation to be in some cases substantially below 1929, but in others appreciably higher.

Industry	Per Cent Change in Real Weekly Earnings 1929 to 1932
Manufacturing	—14.9
Metalliferous Mining	—29.4
Anthracite Coal	+ 3.1
Bituminous Coal	—20.8
Public Utilities	+24.0
Trade	+12.1
Class I Railroads	+ 6.7

It will be seen that in the case of four of these groups, notwithstanding much short time, the employes who were retained in employment had on the average larger real earnings in 1932 than the employes of the same line of industries had in the year 1929. The manufacturing group, which shows a loss of about 15 per cent, includes many more workers than any of the others, but the 15 per cent is an average of all the industries classified under that head, and if the details were available they doubtless would further illustrate the inequality of earnings among wage-workers since 1929, as judged by normal relations. The variations in employment were even greater than in wage-rates and largely due to the failure of wage-rates to conform to general industrial conditions, thus retarding the natural decline of prices and contributing to the unbalanced situation. These are typical of the causes which spread the great depression.

The Farm Situation

It remains true, however, that the most serious of all maladjustments has been that between the prices of what the farmer has to sell and the prices of what he is accustomed to buy. Even in the month ended June 15, 1933, the purchasing power of his principal products, as calculated by the Department of Agriculture was only 62 per cent of the five-year pre-war average, although this compares with 48 in the corresponding month of last year. Nothing has been said about a 30-hour, or even 40-hour, week for him, although a plan has been adopted for a consumption tax upon certain of the principal farm products, the proceeds to be allotted to farmers who will agree to reduce production. The weather also has taken an effective part in reducing production, but whether or not these influences will correct the maladjustment affecting the farmers remains to be seen, since while farm products have been advancing the things which he must buy also have been moving upward.

The Great Question

This review leads to the conclusion that theoretically, the idea of centralized control affords a promise of a better state of order in industry than has existed in the past, or at least better than has existed in the last three years, but obviously this will depend upon the management. The problem is to accomplish by the discriminating exercise of persuasion and authority such a readjustment of relations as will realize the goal described in the quotation from Dr. Ely above. Obviously this cannot be done by increasing all wages and prices together, not correcting the maladjustments. There is something illogical about raising wages in an industry which already is restricted in its operations because its products cannot be sold, for sales are chiefly dependent upon costs and prices. It would seem that so long as millions are wholly out of employment and millions more on part time, it will be desirable to increase employment rather than the costs of living, which affect everybody's purchasing power.

Much anxiety is expressed in Washington lest production may be getting ahead of purchasing power. It is equally important that costs and prices do not get ahead of purchasing power, but the whole truth is that production itself is purchasing power, *and the only purchasing power,* because every individual and group buys the products and services of others with its own products and services. The solution of the whole problem is in balanced relations, and evidently the problem will not be solved by giving exclusive attention to the industries which include only about one-fifth of the gainfully employed population.

After all, the great question does not relate to either the ability or good purposes of any group of men who might be in charge of the experiment, but is simply whether in the nature of democratic governments, any authority thus derived can be expected to successfully find its way through the maze of theories, interests and controversies in which such an undertaking is involved. There is one way by which it may be done, to-wit, by rigorously limiting the scope of regulation to the suppression of unfair and clearly uneconomic policies, but otherwise accepting the guidance of the natural forces which have accomplished all of the economic progress of the past.

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